Accounting Basics, Part 2

It's 10 o'clock, do you know where your money is?

The Accounting Cycle,
T-Accounts,
Trial Balance, and
from Ledger to
Trial Closing Balance

Part 2

What's Here…

- Introduction
- The Accounting Cycle
- T-Accounts
- Trial Balance
- Adjusting Entries
- Closing Entries
- Additional Information
- That's all…

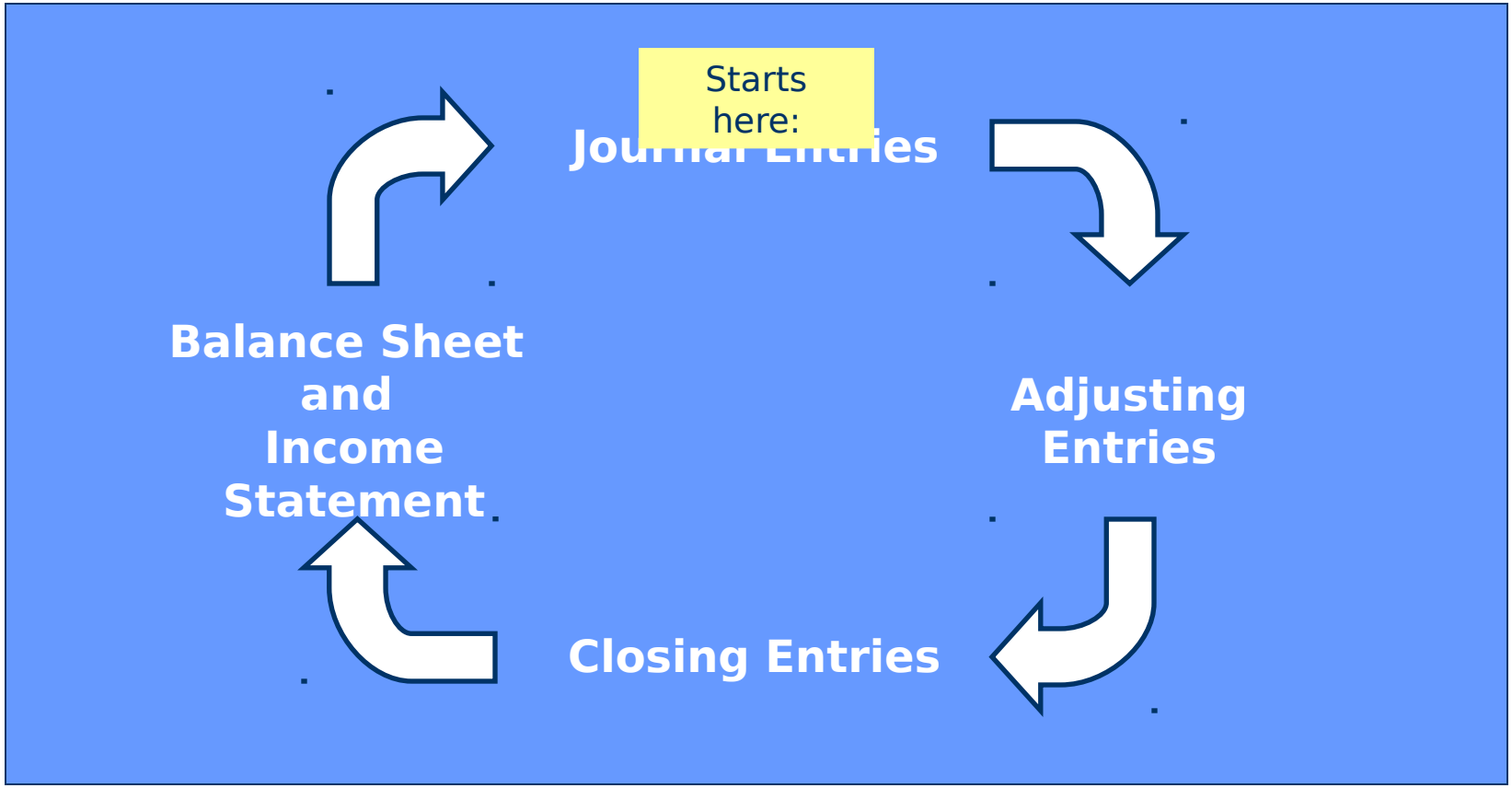
Introduction,
Page 1 of 2

- This *training nugget,* picks up where Part 1 left off. This one illustrates and discusses:
  - The Accounting Cycle
  - T-Accounts
  - Trial Balance
  - Adjusting Entries
  - Closing Entries
  - Trial Closing Balance

Introduction,
Page 2 of 2

- Part 1, started with the Basics by discussing:
  - Business Types
  - Business Organization
  - Professional Advice
  - Accounting and Records
  - Accrual Accounting
  - Basic Bookkeeping
  - Chart of Accounts
  - Double-Entry Accounting
  - Debits & Credits
  - The Journal
  - The Ledger
- Part 3, the next *training nugget* in this series, illustrates and discusses the Balance Sheet, the Income Statement and analyzing financials

Accounting Cycle



Accounting Cycle,
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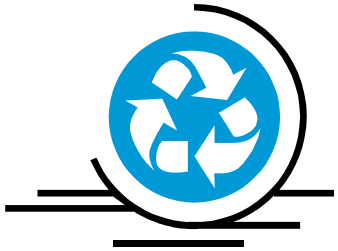

Step 1 Business transactions occur that result in source documents such as receipts, bills, checks, etc.

Step 2 Business transactions are recorded in the Journal chronologically by account name

Step 3 Information is posted (copied) from the Journal to the General Ledger (book in which *accounts* are recorded)

Steps are illustrated on next slide

Accounting Cycle,
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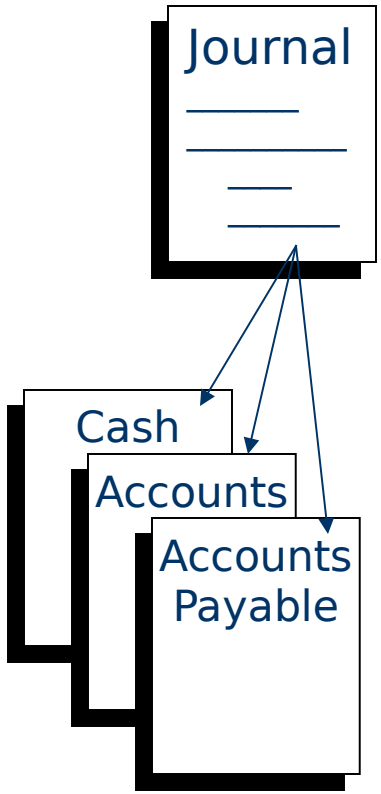

Steps 1 and 2 – Transactions occur resulting in business revenue and expense details that are recorded in the Journal

Step 3 – Information from Journal is posted to applicable ledgers

Recurring transactions are grouped together into like accounts (categories) such as cash, receivables, payables, equipment, etc.

Accounting Cycle,
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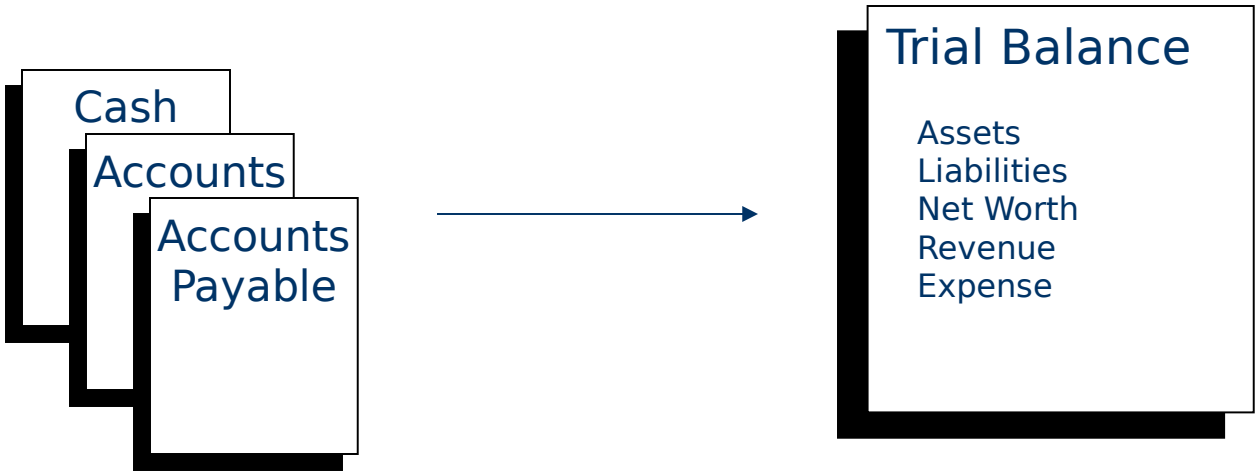
Step 4 A trial balance is prepared which lists, in order, the ending monthly balances of all general ledger accounts



Accounting Cycle,
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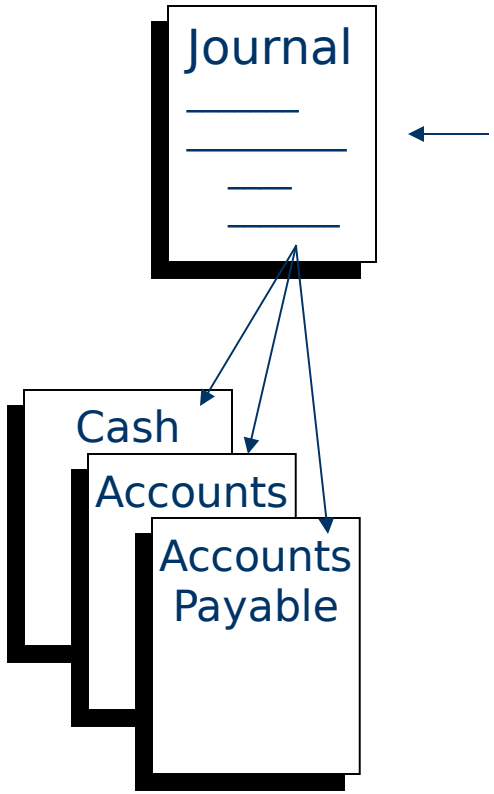
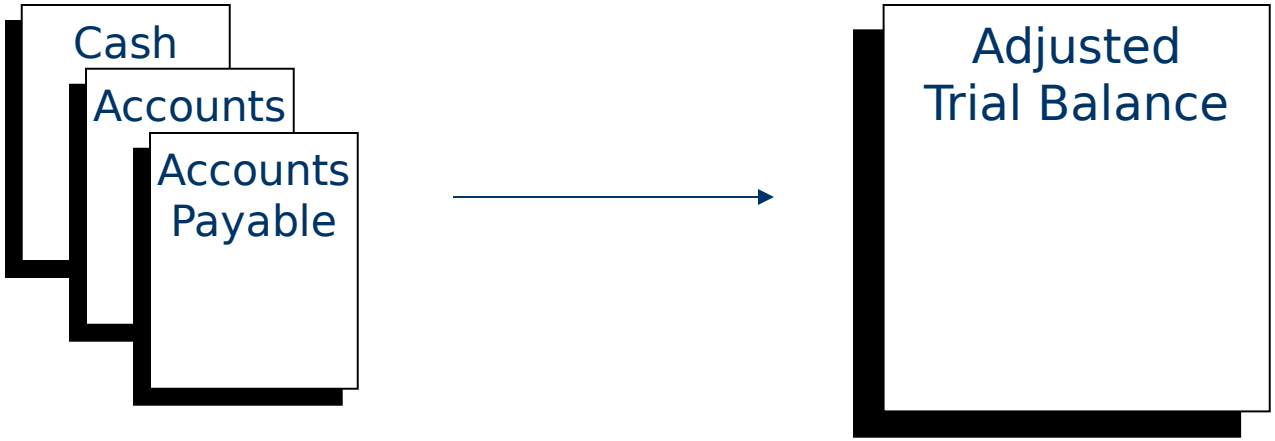


Step 5 Adjusting entries are completed at the end of the accounting period (e.g., monthly) to match proper revenue with expenses in that period

Step 6 Adjusting entries from the Journal are posted into the General Ledger

Accounting Cycle,
Page 6 of 9

Step 7 An adjusted trial balance is prepared that reflects only the adjusting entries. (If an error has occurred, it was made in posting.)



Accounting Cycle,
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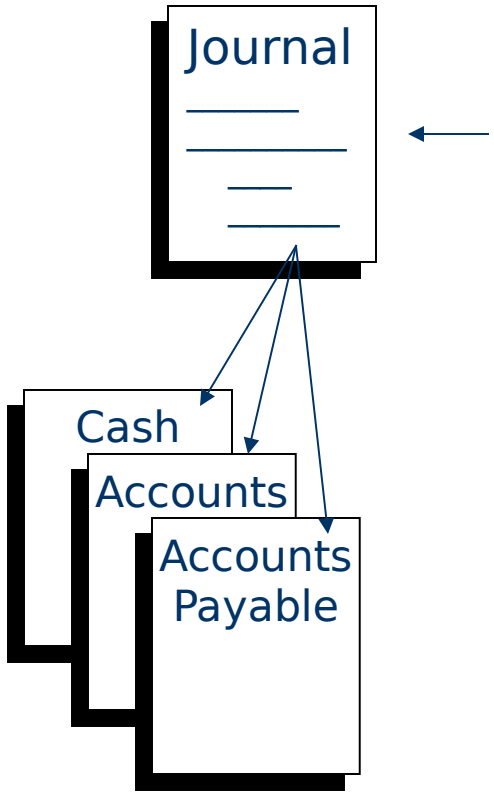

Step 8 All temporary (nominal) accounts are closed and have a zero balance at the beginning of the next accounting period (month)

All closing entries at the end of the accounting period are recorded in the Journal

Accounting Cycle,
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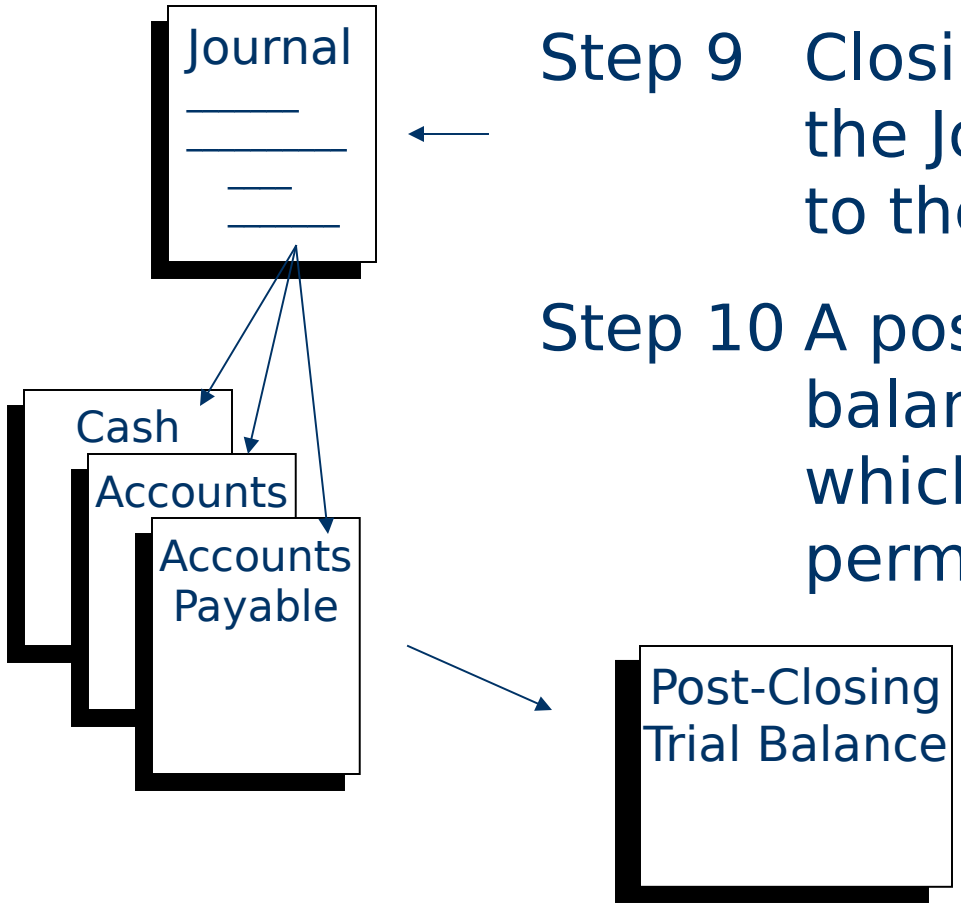

Step 9 Closing entries from the Journal are posted to the General Ledger

Step 10 A post-closing trial balance is prepared which only shows permanent accounts

Accounting Cycle,
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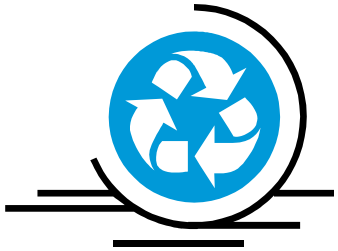

Step 11 Monthly (or periodic) financial statements are prepared:

- Income Statement

  Revenue – Expenses = Net Profit/Loss

- Balance Sheet

  Assets = Liabilities + Net Worth

The Balance Sheet equation cannot balance until net income (or loss) is added to the Balance Sheet from the Income Statement.

T- Accounts,

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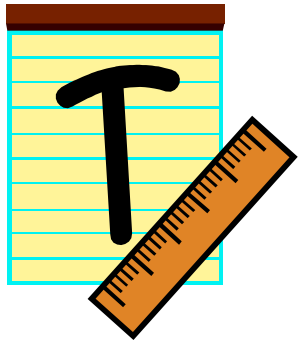

Cash **Account No. 101**

Date 20XX		Item	PR	Debit	Date 20XX		Item	PR	Credit
Jan	1		J1	2500	Jan	2		J1	250
					Jan	3		J1	175
				2500					452
Jan		Balance							
		2048							

Standard Ledger Account … the "T" Account

Footing (adding) helps balance the account.

Ending balance is difference between the footings.

T- Accounts,
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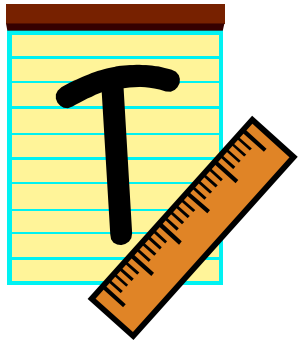

Assets = Liabilities + Net Worth + Revenue - Expenses

Debit	Credit
+	-
Balance	

Debit	Credit
-	+
Balance	

	Credit

	Credit

Debit	
-	

Withdrawals

Debit	lit
+	-

Balances are the differences between debits and credits in the accounts.

Normal balance for all asset accounts are debits.

Normal balance for liability accounts are credits.

T- Accounts,
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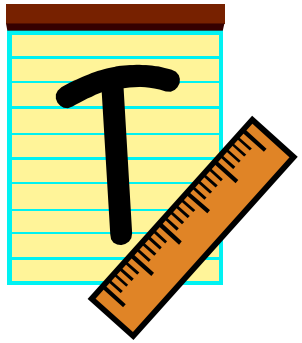

On Jan 1, 20XX, the business owner invested $5000 cash and $100 office equipment in the business.

Cash	
Debit	Credit
5000	

Equipment	
Debit	Credit
100	

Capital	
Debit	Credit
	5100

On Jan 15, 20XX, the business bought a used truck for $1000 cash and a note payable for $4000.

Cash	
Debit	Credit
5000	1000

Truck	
Debit	Credit
5000	

Note Payable	
Debit	Credit
	4000

T- Accounts,
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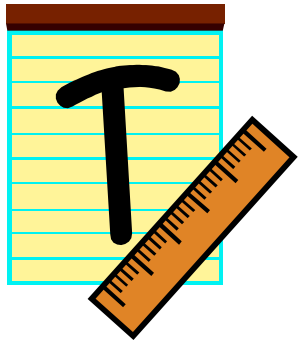

On Jan 17, 20XX, the business earned $2000 for services.

Cash	
Debit	Credit
5000	1000
2000	

Revenue	
Debit	Credit
	2000

On Jan 20, 20XX, the business paid utilities on the building for $200.

Cash	
Debit	Credit
5000	1000
2000	200

Utilities Expense	
Debit	Credit
200	

T- Accounts,
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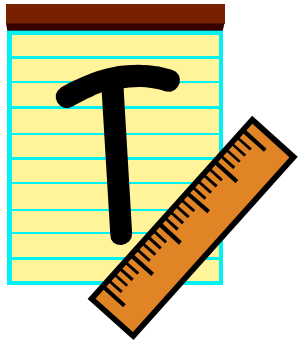

On Jan 21, 20XX, the business paid its monthly building/office rent of $500.

Cash	
Debit	Credit
5000	1000
2000	200
	500

Rent Expense	
Debit	Credit
500	

On Jan 22, 20XX, the business bought office supplies for $250.

Cash	
Debit	Credit
5000	1000
2000	200
	500
	250

Office Supplies	
Debit	Credit
250	

T- Accounts,
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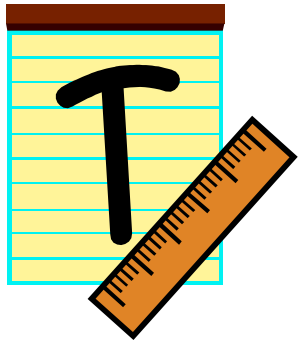

On Jan 24, 20XX, the business owner withdrew $100 cash to pay personal expenses.

Cash

Debit	Credit
5000	1000
2000	200
	500
	250
	100

Withdrawals

Debit	Credit
100	

T- Accounts,
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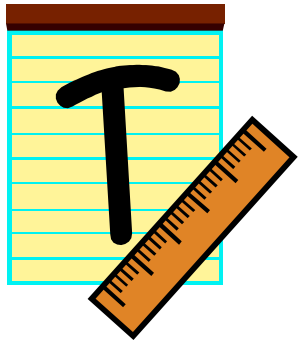

At the end of the month the business transactions were summarized.

Cash

Debit	Credit
5000	
1000	
2000	
200	
	500
	250
	100
	200
	4950

Office Equipment

Debit	Credit
100	

Business Capital

Debit	Credit
	5100

Utilities

Debit	Credit
200	

Truck

Debit	Credit
5000	

Withdrawals

Debit	Credit
100	

Rent

Debit	Credit
500	

Office Supplies

Debit	Credit
250	

Note Payable

Debit	Credit
	4000

Revenue

Debit	Credit
	2000

...to Trial Balance

Trial Balance,
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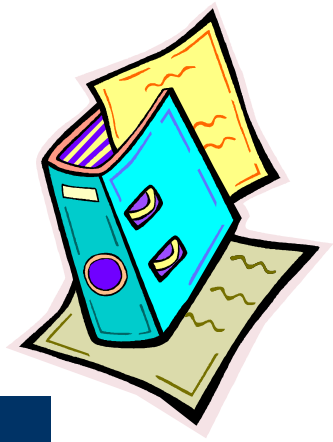

Business Name Trial Balance Date		
	Debit	**Credit**
Cash	$4,950	
Supplies	250	
Equipment	100	
Vehicle	5,000	
Note Payable		4,000
Capital		5,100
Withdrawal	100	
Revenue		2,000
Utilities	200	
Rent	500	
TOTALS	**$11,100**	**$11,100**

Debits = Credits

When the Trial Balance matches (equals), everything is fine.

But, when it doesn't the bookkeeper must backtrack and verify all entries against the business transaction documentation until the discrepancy is discovered.

Corrections are entered and annotated in the Journal, posted to the applicable ledger, and the Trial Balance.

Trial Balance,
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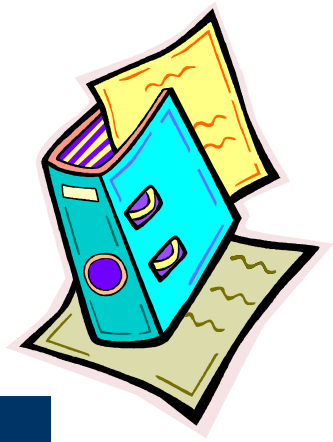

- Prepared at the end of the accounting period
- Prepared from the general ledger
- Each account balance is recorded in order starting with assets, liabilities, net worth, revenue and expenses
- Totals for debits and credits are compared and should equal
- Journals, ledgers and business transaction documentation are reconciled

Adjusting Entries,
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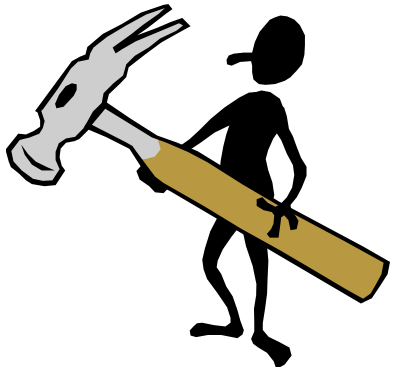

- Made at the end of the month or accounting period
- Made to:
  - Current Assets
  - Long-Term Assets
  - Liabilities
  - Revenue
  - Expense

Adjusting Entries,
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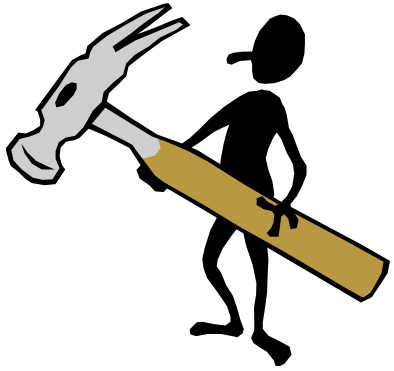
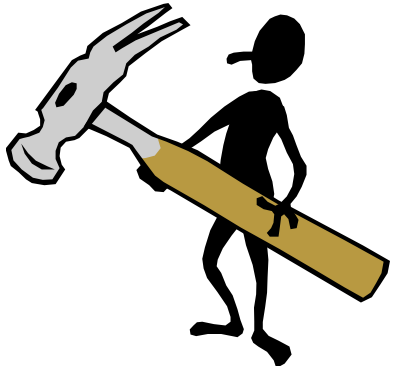


- Cash is never used in an adjusting entry
- An expense or revenue account is used in every transaction
- Expenses will normally be debits and revenue accounts will be credits
- Revenue and Expense Accounts that have been earned, but remain unrecorded, must be adjusted

Adjusting Entries,
Page 3 of 11



Date		Description of Entry	PR	Debit	Credit
20XX					
	10	Cash		50000	
		Capital			50000
		Invested in the business			
	10	Supplies		3500	
		Cash			3500
		Shirts for resale			

1. Adjustments are recorded in the Journal .. Then posted to ledgers

Cash

Accounts

Accounts Payable

Adjusted Trial Balance

2. An <u>adjusted</u> trial balance is prepared to guard against errors.

Adjusting Entries,
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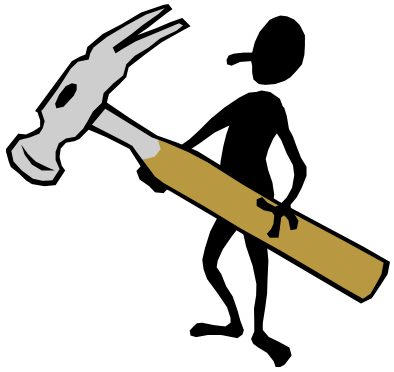

- Asset
  - Accounts such as prepaid insurance, office supplies, prepaid rent have been paid in advance and recorded as assets. These should be expensed as used.
- Liabilities
  - A unique liability may be created when services are paid in advance for something the business has not yet done. This receipt of cash increased the cash account and a liability called *Unearned Revenue* which remains in this account until “earned”. As it is “earned” it is transferred out of this account and into Revenue.

Adjusting Entries,
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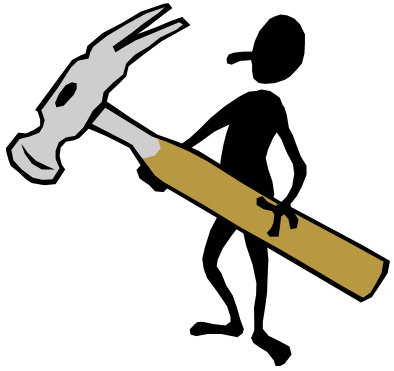

- Accrued Expense
  - These are expenses that have been *incurred*, but *not yet paid.*
- Accrued Revenue
  - A job will not be completed for several months and the business won't get paid until the end of the job. At the end of the first month, an adjusting entry is needed for the amount of earnings in the current month, even though the job is not yet completed and no bill has been sent.

Business Name: Trial Balance	Date _____	
	Debit	**Credit**
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		1500.00
Mortgage Payable		80000.00
Capital		27500.00
Withdrawals	12000.00	

Adjusting Entries,

Page 6 of 11

This sample trial balance will be used to demonstrate end-of-month/period adjusting entries for:

- Current Assets
- Long-Term Assets
- Current Liabilities
- Accrued Expense
- Accrued Revenue

While each of the examples are separate, all of these that are applicable would be made and an Adjusted Trial Balance prepared.

Adjustments will appear in

Business Name:

Date _____
Adjusted Trial Balance

	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
	300.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		1500.00

Adjusting Entries, Page 7 of 11

Adjusting Current Assets:

Date			P.R.	Debit	Credit
Dec	31	Office Supplies Exp		100	
		Office Supplies			100

Current assets are adjusted by removing the used amount from the asset account and transferring it to the expense account.

Business Name:

Date _____
Adjusted Trial Balance

	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Accumulated Depreciation		2000.00
Automobiles	24000.00	
Accumulated Depreciation		5000.00
Buildings	80000.00	
Accumulated Depreciation		4000.00
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		1500.00
Mortgage Payable		80000.00
Capital		27500.00
Withdrawals	12000.00	

Adjusting Entries, Page 8 of 11

Adjusting Long-Term Assets:

Date			P.R.	Debit	Credit
Dec	31	Depreciation Expense, Equip	J16	2000	
		Accumulated Depreciation	J17		2000
Dec	31	Depreciation Expense, Auto	J18	5000	
		Accumulated Depreciation	J19		5000
Dec	31	Depreciation Expense, Bldg	J20	4000	
		Accumulated Depreciation	J21		4000

Long-term assets need to be adjusted for the amount of depreciation (use) for the accounting period. AN account called Accumulated Depreciation is used. This account is a contra-asset account (credit balance) instead of a the normal debit balance of an asset.

The difference between cost and depreciation is known as *book value. (e.g., equip cost 10000 – 2000 depreciation = 8000 book value.)*

Business Name:

Date _____
Adjusted Trial Balance

	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		1500.00
		1000.00

Adjusting Entries, Page 9 of 11

Adjusting Current Liabilities:

Date			P.R.	Debit	Credit
Dec	31	Unearned Revenue		500	
		Revenue			500

Earnings of $500 are recorded as revenue from the liability account. The liability account was created when the company received cash in advance, but had not earned the amount. When the amount is earned, it is transferred to the revenue account.

Business Name:

Date _____
Adjusted Trial Balance

	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Wage Payable		1500.00
Notes Payable		15000.00
Unearned Revenue		1500.00

Adjusting Entries, Page 10 of 11

Adjusting Accrued Expense:

Date			P.R.	Debit	Credit
Dec	31	Wage Expense		1500	
		Wage Payable			1500

This entry would be made by a company that pays payroll on the 5th and 20th of the month. The last days of the month would be recorded as a payable, because the expense had been incurred, but the company will not make a payment until the 5th.

Business Name:

Date _____
Adjusted Trial Balance

	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
	6000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		1500.00

Adjusting Entries, Page 11 of 11

Adjusting Accrued Revenue:

Date			P.R.	Debit	Credit
Dec	31	Accounts Receivable		1000	
		Revenue			1000

This entry is made for a job that is not completed by the end of the accounting period, but needs to be recorded since the service was performed in the accounting period.

Closing Entries,
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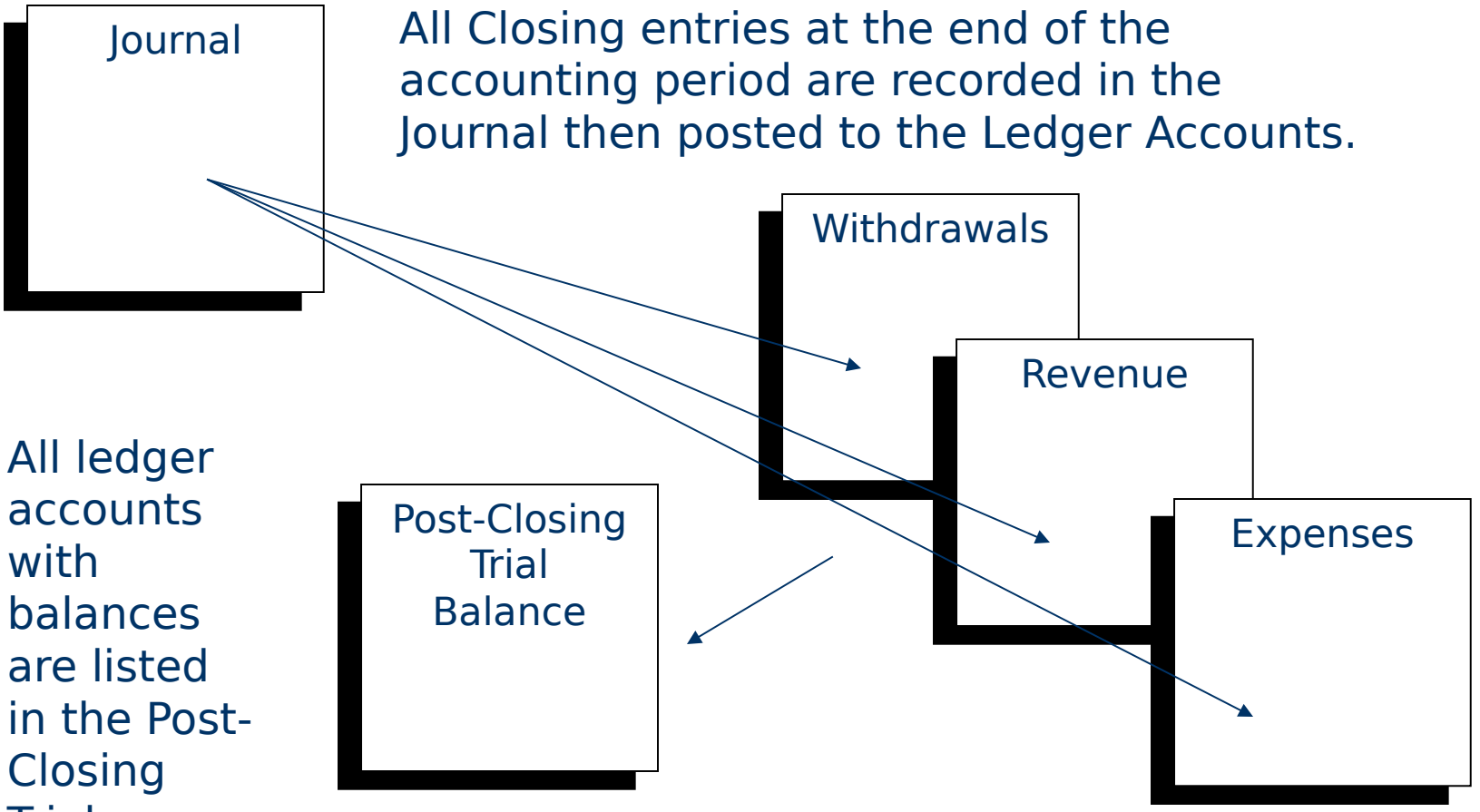


All Closing entries at the end of the accounting period are recorded in the Journal then posted to the Ledger Accounts.

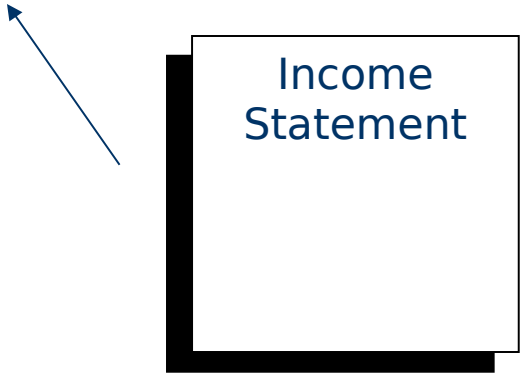
All ledger accounts with balances are listed in the Post-Closing Trial

Closing Entries,
Page 2 of 4

- At the end of each month, the revenue, expense and withdrawal accounts are closed to zero balance
- Closing entries move the difference between revenue and expense from the income statement to net worth (owner's equity)

Closing Entries,
Page 3 of 4

- Assets = Liabilities + Net Worth



The Balance Sheet equation cannot balance with the amount of profit or loss from the Income Statement

Closing Entries,
Page 4 of 4

- All revenue accounts start over at the end of each month. The revenue accounts are closed to the Expense and Income Summary
- All expense accounts are closed into the Expense and Income Summary
- The Expense and Income Summary account is closed
- The Withdrawal Account is closed

Additional Information, Page 1 of 2

- See references and resources listed as “additional information” at end of *Training Nugget* Part 1
- Financial definitions are provided in a separate *training nugget*
- Basic Accounting *Training Nugget,* Part 1, covers:

  - Business Types
  - Business Organization
  - Professional Advice
  - Accounting and Records
  - Accrual Accounting
  - Basic Bookkeeping
  - Chart of Accounts
  - Double-Entry Accounting
  - Debits & Credits
  - The Journal
  - The Ledger

Additional Information,

- Basic Accounting *Training Nugget,* Part 3, covers:
  - Balance Sheet
  - Income Statement
  - Analyzing financial reports

That’s all for now…

Do you know where your money is?

Suggestions and requests to:

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